FILE COPY

Office - Supreme Court, U. S.
FILED
JAN 27 1942
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 581.
No. 582.

ADOLPH B. SPRECKELS, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

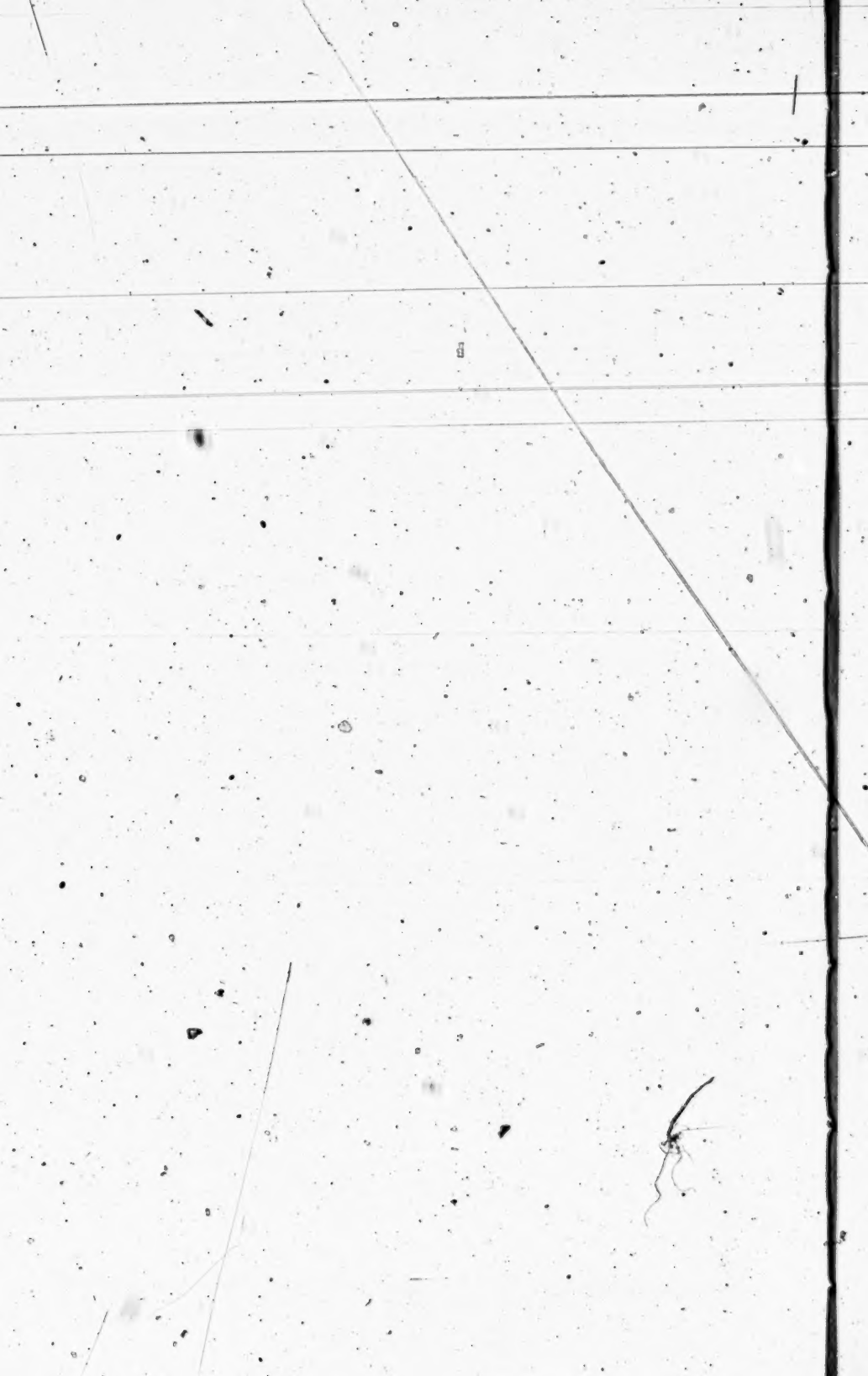
On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR THE PETITIONER.

WALTER SLACK,
433 California St.,
San Francisco, Calif.

THOMAS M. WILKINS,
Union Trust Bldg.,
Washington, D. C.,
Attorneys for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.



INDEX.

Opinions below 1

Jurisdiction 1

Question Presented 2

Statute and Regulations Involved 2

Statute 2

Regulations 3

Statement 4

Argument: 5

A taxpayer engaged in the business of purchasing and selling stocks, bonds and commodities for profit during the years 1934 and 1935 is entitled to deduct the selling commissions, incident to the said sales of securities and commodities as "compensation for personal services actually rendered."

Conclusion 27

CITATIONS.

Cases:

Biddle v. Commissioner, 302 U. S. 574, 582 ..... 25, 26

Brewster v. Walsh, 268 Fed. 207, 209 18

Burnet v. Thompson Oil & Gas Co., 283 U. S. 301, 304 19

Caminetti v. United States, 242 U. S. 470 26

Central Real Estate Co. v. Commissioner, 47 Fed. (2d) 1036, 1037 12

Colony Coal & Coke Corp. v. Commissioner, 52 Fed. (2d) 923 15

Commissioner v. Covington, 120 Fed. (2d) 768, 771 ..23, 24

Dart v. Commissioner, 74 Fed. (2d) 845, 847 15

De Ganey v. Lederer, 250 U. S. 376, 381 26

Deputy v. Du Pont, 308 U. S. 488, 495, 60 S. Ct. 363, 367 15

Ex Parte Public National Bank, 278 U. S. 101 26

Goodrich v. Edwards, 255 U. S. 527, 534 ..... 17, 18

Haggar Co. v. Helvering, 308 U. S. 389, 400 17

Helvering v. Horst, 311 U. S. 112, 116, 61 S. Ct. 144, 147 19

Page

Helvering v. Independent Life Ins. Co., 292 U. S. 371, 381 19
Helvering v. New York Trust Co., 292 U. S. 455, 467, 468, 469 ..... 17, 25, 26
Helvering v. Union Pacific Railroad Co., 293 U. S. 282, 285 ..... 11, 23
Helvering v. Winmill, 305 U. S. 79, 59 S. Ct. 45 ..... 8, 9, 10, 11, 13, 19, 22, 23
Helvering v. Winmill, No. 860, October Term 1937, Trans. p. 10 22
Helvering v. Winmill, No. 11, October Term 1938, Petitioners Main Brief p. 3 ..... 8, 22
Higgins v. Commissioner, 312 U. S. 212, 61 S. Ct. 475 25
Highlands Trust, The, No. 1546, 32 B. T. A. 760 (6-12-35) 20
Kornhauser v. United States, 276 U. S. 145 21
Lake County v. Rollins, 130 U. S. 662, 670 26
Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 519 ..... 17, 18
New Colonial Ice Co. Inc. v. Helvering, 292 U. S. 435, 440 19
Spreckels v. Commissioner, 41 B. T. A. 1204 1
Spreckels v. Commissioner, 119 Fed. (2d) 667 ..... 1, 5, 8
Sprunt, Alexander & Son, Inc. v. Commissioner, 64 Fed. (2d) 424, 428 21
United States v. Colorado & N. W. R. Co. (C. C. A.) 157 F. 321, 327 26
United States v. Fisher, 2 Cranch, 358, 386 26
United States v. Missouri Pacific Railroad Co., 278 U. S. 269, 277 26
United States v. Wiltberger, 5 Wheat. 76, 95-96 26
Walsh v. Brewster, 255 U. S. 536, 538 ..... 16, 17, 18
Walsh v. Brewster, p. 14, No. 742, October Term, 1920 18
Whitman, Clarence, v. Commissioner, 16 B. T. A. 197, 199, Aff'd. C. C. A. 2, 49 F. 2d 1087 21
Winmill, Helvering v., 305 U. S. 79 ..... 8, 9, 10, 11, 13, 19, 22, 23
Winmill v. Helvering, 93 Fed. (2d) 494 22

CONGRESSIONAL COMMITTEE REPORTS:

Senate Finance Committee Report, 67th Cong. 1st Sess., S. Rep. 275, p. 10 18

Page

Senate Finance Committee Report, 68th Cong. 1st Sess., S. Rep. 398, p. 13 17
Ways and Means Committee Report, 67th Cong. 1st Sess., H. Rept. 350, p. 9 18
Ways and Means Committee Report, 68th Cong. 1st Sess., H. Rept. 179, p. 12 ..... 12, 16

INTERNAL REVENUE RULINGS:

I. T. 2305 C. B. V-2, p. 108 ..... 13, 14, 20, 21
G. C. M. 15430, C. B. XIV-2, p. 59 ..... 7, 10, 14, 23, 24, 25

MISCELLANEOUS:

Kester, Roy B., Advanced Accounting—Third Edition, p. 13 12
Ann. Cas. 1917B, 1168 26
L. R. A. 1917F, 502 26
13 Ann. Cas. 893 26
15 L. R. A. (N. S.) 167 26

TREASURY DEPARTMENT REGULATIONS:

Regulations 33, Article 116 17
Regulations 45, Article 292 10
Regulations 62, Article 293 10
Regulations 65, Article 292 10
Regulations 69, Article 292 10
Regulations 74, Article 282 10
Regulations 77, Article 121 ..... 8, 9, 22
Regulations 77, Article 282 ..... 8, 9, 10, 11, 21, 23
Regulations 86, Article 23 (a)-1 ..... 3, 7
Regulation 86, Article 24-2 ..... 7, 10, 13
Regulations 94, Article 24-2 ..... 4, 7, 10
Regulations 101, Article 24-2 10
Regulations 103, Sec. 19, 24-2 10

INTERNAL REVENUE LAWS: (U. S. C. A. Title 26)

Revenue Act of 1921, Section 202 (b) (1), (2), (3) (42 Stat. L. 227, C. 136) 17, 18
Revenue Act of 1924 (43 Stat. L. 253, C. 234), Section 202 (a) 12, 16
Section 202 (c) 12, 16

Page

Revenue Act of 1926, Section 214 (a)(1) (44 Stat. L. 2 C. 27) 15
Revenue Act of 1928, Section 23 (45 Stat. L. 791, C. 852) 15
Revenue Act of 1932, Section 23 (r) (47 Stat. L. 169, C. 209) 10, 11
Revenue Act of 1934, (48 Stat. L. 680, C. 277),
Section 23 (a) 2, 6, 13, 14, 26
Section 111 (a), (b) 2, 7, 13, 16, 20, 21
Section 113 (b) 3, 7, 13, 17, 19, 21
Section 113 (b) (1) (A).....3, 8, 13, 19, 22
Revenue Act of 1936 (49 Stat. L. 1648, C. 690) 13
Revenue Act of 1938 (52 Stat. L. 447, C. 289) 13

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 581.
No. 582.

ADOLPH B. SPRECKELS, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR THE PETITIONER.

OPINIONS BELOW.

The opinion in the Board of Tax Appeals (R. 26 to 31 in No. 581 and R. 22 to 28 in No. 582) is reported in 41 B. T. A. 1204. The opinion of the Circuit Court of Appeals (R. 52 to 65 in No. 581) is reported in 119 Fed. (2d) 667.

JURISDICTION.

The judgment of the United States Circuit Court of Appeals was entered May 15, 1941 in both proceedings. (R. 66 in No. 581 and R. 45 in No. 582) Timely petition for rehearing in both causes by that Court was denied July 28, 1941. (R. 67 in No. 581) The petition for a writ of cer-

tiorari was filed on September 3, 1941 and was granted on October 20, 1941. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the act of February 13, 1925. (U. S. C. Title 28, Section 347)

QUESTION PRESENTED.

Whether a taxpayer who is engaged in the business of buying and selling securities and commodities for profit is entitled in the determination of his income tax liability to deduct commissions necessarily paid by him in connection with such sales.

STATUTE AND REGULATIONS INVOLVED.

Statute:

Revenue Act of 1934, C. 277, 48 Stat. 680:

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered: * * * 26 U. S. C. A.

* * * * * * * * * *

Sec. 111. Determination of Amount of, and Recognition of, Gain or Loss.

(a) Computation of Gain or Loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) Amount realized.—The amount realized from the sale or other disposition of property shall be the sum

of any money received, plus the fair market value of the property (other than money) received.

• • • • • • • • • • •

Sec. 113. Adjusted Basis for Determining Gain or Loss.

• • •

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(b) (1) General Rule.—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years • • •. 26 U. S. C. A.

• • • • • • • • • • •

Regulations:

Reg. 86, Art. 23 (a)-1. Business expenses.

Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 23 (b)-1 to 23 (q)-1. Double deductions are not permitted. Amounts deducted under one provision of the Act can not again be deducted under any other provision of the Act. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 22 (a)-5.) Among the items included in business expenses are management expenses, *commissions*, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 23 (a)-2),

advertising and other *selling expenses*, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property." * * * (Italics supplied.)

Art. 24-2. Capital expenditures.

Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (1).) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the bulding. Commissions paid in purchasing securities are a part of the cost price of such securities. *Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price.* * * * (Italics supplied)

STATEMENT.

Petitioner, during the years 1934 and 1935, was engaged in the business of purchasing and selling stocks, bonds and commodities for profit. (R. 24) In due course he filed his income tax returns for the calendar years 1934 and 1935. Thereafter, the respondent, Commissioner, asserted deficiencies in tax for the two years upon grounds that are not here material. Petitioner filed petitions with the Board of Tax Appeals for redetermination of the asserted deficiencies. All errors raised in the original petitions were disposed of by stipulation prior to trial. At the hearing before the Board, petitioner asked and was granted leave to file amendments to his two petitions alleging that during each calendar year he had paid, in the conduct of his business, selling commissions on sales of stocks, bonds and commodities which he had not taken as deductions in computing his

income tax for those years and asserted the right to have those deductions considered in determining his taxable income. (R. 23) These claims, if conceded, resulted in the overpayment of his income tax for both years.

The two petitions were consolidated for hearing and were disposed of by the Board in a single opinion, although separate decisions were entered. The Board found the facts as above stated and held that the selling commissions were deductible as ordinary and necessary expenses of taxpayer's business, but, as to the year 1934, held that the amendment to the petition having been filed more than three years after the payment of the last installment of tax, a refund based upon the failure to claim a deduction for selling commissions was barred by the statute of limitations. (R. 27-31)

Petitioner applied to the Circuit Court of Appeals for the Ninth Circuit for a review of the decision entered for 1934, while the Commissioner brought up the decision as to 1935. Both petitions were considered together by the Circuit Court of Appeals, the Court saying:

> "* * * the basic question before this court in each case is identical; only in the event that our conclusion on deductibility is in the taxpayer's favor will it be necessary to consider whether the claim for refund for 1934 was timely filed." (119 Fed. (2d) 669, R. 55, No. 581)

ARGUMENT.

A taxpayer engaged in the business of purchasing and selling stocks, bonds and commodities for profit during the years 1934 and 1935 is entitled to deduct the selling commissions, incident to the said sales of securities and commodities as "compensation for personal services actually rendered."

The Board of Tax Appeals found as a fact in both No. 581 and No. 582 that "petitioner was engaged in the business of purchasing and selling stocks, bonds and commodities for profit." (R. 24 as to No. 581, R. 21 as to 582) In-

asmuch as there is nothing in the record inconsistent with this finding or which would cast the slightest suspicion upon its correctness, it is completely out of order to question that finding of fact for the first time in the Supreme Court of the United States.

It must be assumed, therefore, that this taxpayer was engaged in a "trade or business" when he bought and sold securities and commodities for his own account during the years 1934 and 1935.

Under Section 23 of the Revenue Act of 1934.

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for * * * compensation for personal services actually rendered."

"shall be allowed as deductions" in computing net income.

Obviously, the brokerage commissions paid by the petitioner during the taxable years involved on the sales of securities and commodities constitute "compensation for personal services actually rendered." Obviously further, these brokerage commissions were "paid or incurred during the taxable year in carrying on any trade or business." That is, they were paid or incurred during the taxable year in carrying on the taxpayer's "business of purchasing and selling stocks, bonds and commodities for profit." (R. 24 as to No. 581 and R. 21 as to No. 582)

If these brokerage commissions constitute "ordinary and necessary expenses" incurred in petitioner's said business, they are deductible in computing his net income, unless by some other more specific provision of the statute these expenses are *clearly* to be treated otherwise.

Petitioner was engaged in a business in which selling stocks, bonds and commodities was necessary, and in order adequately to facilitate this selling in appropriate volume and with reasonable promptness, petitioner found it necessary to pay these expenses. It is the normal and common practice and hence ordinary for persons engaged in the business of buying and selling stocks, bonds and commodities

for profit, to use the facilities of the New York, Chicago or other stock exchanges and to pay the standard compensation fixed for these necessary services.

Article 23 (a)-1 of Regulations 86 dealing with "business expenses" states in part,

> "Among the items included in business expenses are management expenses, commissions, * * * selling expenses, * * * etc."

In reversing the holding of the United States Board of Tax Appeals that this compensation constituted ordinary and necessary business expenses, the lower court found that the above quoted provision of Article 23 (a)-1 must be read in conjunction with the provisions in Article 24-2 of Regulations 86 wherein it is provided that

> "Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price."

After referring to G. C. M. 15430, C. B. XIV-2, page 59, it expressed the belief that only in the case of a "dealer in securities" as distinguished from a "trader" could "commissions paid in selling securities be ordinary and necessary business expenses."

The Court ignores completely the fact that not only was petitioner engaged in the business of buying and selling *stocks* and *bonds*, but petitioner's business also consisted of buying and selling *commodities* for profit. Obviously this negative reference in Article 24-2, which relates primarily to *capital expenditures*, and specifically to "commissions paid in selling *securities*," can have no bearing upon commissions paid in selling *commodities*. Consequently that part of the Regulations (Article 23 (a)-1 relating to "commissions" and "selling expenses" must govern the commissions applicable to petitioner's *commodity* sales, in the absence of any more specific reference to such commissions. Furthermore, in the light of the Statute (Sec. 111 and Sec. 113) and the Regulations (Art. 23 (a) (1)), in the absence of any provision in the Regulations *specifically* or

even *inferentially* holding *security selling commissions* paid in carrying on the business of buying and selling stocks, bonds and commodities for profit, *not* to be an ordinary and necessary business expense, such commissions are not withdrawn from the general classification of Article 121, but remain deductible under its provisions.

The lower court concluded its opinion with the following argument:

> "No compelling reason, however, presents itself to us for treating purchasing commissions, concededly non-deductible as expenses, differently from selling commissions. If the purchase commissions are to be regarded as a part of the cost of the securities, then, logically, the selling commissions should be considered as an offset against the sale price." 119 Fed. (2d) 672, R. 64.

This negative approach ignores the reason which prompted this Court to hold purchasing commissions to be regarded as part of the cost, rather than ordinary and necessary business expenses.

In asking this Court in the *Winmill* case to hold that brokerage purchase commissions constitute "part of the cost price of securities," under the statutory definition of "cost," the Government quoted in its brief for the petitioner and relied upon Section 113 (b) (1) (A) which requires the inclusion in cost of "items, properly chargeable to capital account." (Page 3, petitioner's main brief, No. 11, October Term 1938.) *Helvering* v. *Winmill*, 305 U. S. 79.

This Court, accordingly, held brokerage buying commissions to be "an element of the cost of securities," quoting in the margin of its opinion that part of the statutory definition of "cost" (Section 113 (b) (1) (A)) requiring the inclusion therein of "items, properly chargeable to capital account." This Court also quoted from that part of Article 282 of Regulations 77, "which specifically and particularly declares that 'commissions paid in purchasing securities are a part of the cost price of such securities.'".

It was these latter "special provisions" which this Court held to limit the application of the broader term "commissions" as used in Article 121 in defining "business expenses."

This Court said specifically that

> "The special designation of security purchase commissions as 'part of the cost price of such securities' contained in Article 282 evinces the clear intent to withdraw that special type of commission from the general classification of Article 121." 305 U. S. 79, 83, 84.

On the basis of these particular statutory provisions and provisions of the Treasury Regulations, this Court held that these "interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." 305 U. S. 79, 83.

No such statutory authority or authority of Treasury Regulations or interpretations long-continued, exist in the instant case consistent with the position now taken by the Government to regard the business expenses in the instant case as not coming within the clear statutory provisions for their treatment as ordinary and necessary business expenses.

It is not enough to say that because "purchase commissions are to be regarded as a part of the cost of securities, then, logically, the selling commissions should be considered as an offset against the sales price."

Obviously the clear language of the statute and the regulations quoted above, which is limited to only such purchase commissions, cannot be so construed as to include as well selling commissions on securities, which are otherwise specifically provided for and selling commissions on *commodities* which are nowhere provided for in the regulations, so as to render inapplicable the specific words of the statute following a specious application of logic predicated merely on a supposed analogy between buying commissions and selling commissions.

G. C. M. 15430, relied upon by the lower court to support this view, does not represent a long-continued construction of law and regulations by administrative officers charged by the enforcement thereof.

This ruling is a mere opinion of the law officer of the Bureau of Internal Revenue which was rendered while the *Winmill* matter was in litigation, and at a time several years after Article 282 of Regulations 77 (promulgated under the Revenue Act of 1932) appeared including for the first time the modification impliedly permitting the deduction of commissions paid in selling securities when such commissions are ordinary and necessary business expenses.

This part of the regulations, as modified, commencing with the regulations under the 1932 Act reads as follows:

> "Commissions paid in selling securities, *when such commissions are not an ordinary and necessary business expense,* are an offset against the selling price." (the words in italics were added for the first time after the enactment of Sec. 23 (r) of the 1932 Act.)

See also Article 24-2, Regulations 86 (under the Revenue Act of 1934), Regulations 94 (under the Revenue Act of 1936), Regulations 101 (under the Revenue Act of 1938), Section 19.24-2, Regulations 103 (under the Internal Revenue Code).

Prior to Regulations 77 the corresponding language of the Regulations read merely as follows:

> "Commissions paid in selling securities are an offset against the selling price." See Article 292, Regulations 45, Article 293, Regulations 62, Article 292, Regulations 65, Article 292, Regulations 69 and Article 282, Regulations 74.

The occasion for this modification of these regulations coincided with the change in the law adopted for the first time in Section 23 (r) of the 1932 Act limiting the losses on sales or exchanges of stocks and bonds which are not "capital assets," to the extent of the gains from such sales or exchanges.

Under the revenue act of 1932, therefore, when losses sustained in security transactions were for the first time limited by the provisions of Section 23 (r) of the Revenue Act of 1932, then, for the first time, it became no longer *immaterial* how these commissions were treated. Then it was for the first time also that the Commissioner modified the regulations to the effect that selling commissions were an offset to the selling price by adding (in Article 282, Regulations 77) the phrase "when such commissions are not an ordinary and necessary business expense."

Under all these circumstances, therefore, the reference by this Court in the *Winmill* case to that part of its opinion in *Helvering* v. *Union Pacific Railroad Co.*, 293 U. S. 282, 286, 55 S. Ct. 165, 167, regarding these *former* regulations as to the handling of brokerage *selling* commissions, cannot fairly be construed as an approval of the former regulations as to *selling* commissions, as applied to securities sold in the course of one's trade or business *after the law was changed*. This limitation of stock losses was such a substantial change in the Revenue Act as to warrant the modification of Article 282 of Regulations 77 as to selling commissions. In the *Union Pacific* case this Court obviously was primarily concerned to see that the taxpayer got the deduction in one way or another. Under the circumstances involved in that case and under the law as it then existed, it was *immaterial* whether commissions were deducted as a deferred expense or were offset against the issuing price.

In limiting its decision in the *Winmill* case to the question of the deductibility of broker's *purchase* commissions, this Court said (at page 84 of 305 U. S. and 47 of 59 S. Ct.):

> "This new statutory restriction of the allowance for losses from sales of stock bears no such relationship to the *definition of cost price* (Sec. 113) of securities as to lead to the conclusion that Congress intended to overthrow and abandon a settled practice of determining the *elements of cost*." (Emphasis ours)

There is nothing in the *"definition of cost price"* contained in Section 113 of the Revenue act constituting broker's *selling* commissions an "element of cost". The only statutory authority for deducting such selling commissions was as an ordinary and necessary expense. Selling commissions were never allowable under the statute as one of the "elements of cost." Yet prior to 1932 selling commissions always had been recognized as currently deductible. To say that they were an offset to selling price does not make them analogous to buying commissions, which are made "elements of cost" by the statutory language "properly chargeable to capital account." This language has no application to *selling* commissions and for this reason selling commissions are fundamentally different from buying commissions.

Of the words "properly chargeable to capital account" it has been held that they clearly contemplate only "such items as add to the value of property." *Central Real Estate Company* v. *Commissioner*, 47 Fed. (2d) 1036, 1037.

The words "properly chargeable to capital account" were used for the first time in the federal income tax law in Section 202 of the Revenue Act of 1924. When this new language was being adopted, the report of the Ways and Means Committee (68th Cong., 1st Sess., H. Rept. 179, pages 12 and 13) explained that:

> "Under this provision capital charges, such as improvements, and betterments, and carrying charges, such as taxes on unproductive property, are to be added to the cost of the property in determining the gain or loss from its *subsequent sale*, and items such as depreciation and obsolescence previously allowed with respect to the property are to be subtracted from the cost of the property in determining the gain or loss from its *subsequent sale*." (Italics supplied)

The definition of capital and revenue expenditures, in so far as material here will be found in *"Advanced Accounting"* by Roy B. Kester, Third Edition, page 13. It reads as follows:

"Capital expenditures may be defined as expenditures of funds or other assets on capital account. *In accounting language, they may be said to be those expenditures which result in charges to some asset account.*" (Emphasis ours)

On the basis of this generally recognized definition of capital charges, how can it be said that *selling commissions* result in charges to any capital account? Obligations to pay the selling commissions do not arise until the capital asset has been disposed of and the account has disappeared from the books. By no stretch of the imagination are selling commissions *capital expenditures* or charges, nor are they items "properly chargeable to capital account." They are ordinary and necessary expenses of carrying on the trade or business of buying and selling securities. Furthermore, the Commissioner's Regulations 86, Article 24-2, at the very outset define "capital expenditures" as: "Amounts paid for increasing capital value." These are the universally recognized accounting rules with respect to capital expenditures. When later in that Article it is said "commissions paid in selling securities, *when such commissions are not ordinary and necessary business expenses,* are an offset against the selling price," it does not mean that to offset against the selling price is to capitalize an item. See IT 2305 page 20, *infra.* If the Commissioner had thought that "an offset against the selling price" was a *capital* item, he would have said so, at that point in his regulations, but he avoided any such assertion in his article on "capital expenditures."

The subsequent reenactment without substantial change in this regard of the Revenue Acts of 1934, 1936, 1938, etc. has given tacit congressional approval to the modification of Art. 282 Regs. 77, Art. 24-2 Regs. 86, 94, 101 and 103, and gives recognition to the view that selling commissions frequently are ordinary and necessary expenses of doing business and as such are deductible. This added language is not idle language, it was placed in the Regulations as a

modification thereof for the purpose of giving recognition to the obvious fact that *selling* commissions are not "properly chargeable to capital account," but are ordinary and necessary business expenses in certain cases. There is nothing in the *Winmill* case to the contrary. This present case is certainly one of those intended to be covered by the modification and it cannot be distinguished on any moral, economic or legal ground from the situation of the brokerage selling commissions of a "dealer in securities."

It certainly never was the consistent practice of the Bureau of Internal Revenue to offset selling commissions on property sold in the course of one's trade or business. Quite on the contrary, it has been the long established custom of the Bureau of Internal Revenue to allow selling commissions as deductions when such commissions are paid with respect to *property* sold in the course of a trade or business of the taxpayer. This practice is evidenced by the Commissioner's published ruling which is still in force, namely, I. T 2305, quoted on page 20 of this brief.

In the case of casual sales of "stocks and bonds" not sold in the course of a trade or business carried on by the taxpayer, such commissions were not ordinary and necessary expenses of doing business, but in the case of a person engaged in the business of buying and selling stocks and bonds and commodities, a distinction was justified and necessary in order that these business expenses might be properly reflected under Section 23 (a).

Hence the Commissioner, by this contemporary modification of these pre-existing regulations, gave recognition to the difference between such *casual* sales of securities and sales of securities *in the course of a trade or business.*

Thus it cannot accurately be said, as argued by the lower court, that G. C. M. 15430 (C. B. XIV-2, page 59, promulgated on September 23, 1935) was "the statement of the long-continued construction of law and regulations by the administrative officers charged with the enforcement thereof."

Moreover it is wholly without significance with respect to the deductibility of business expenses that "dealers in securities" are treated differently from "traders" in stocks and bonds with respect to the matter of *inventorying* securities.

In this regard, the Commissioner of Internal Revenue unsuccessfully sought to make this distinction between "dealers in securities" and "traders" in the case of *Dart* v. *Commissioner*, 74 Fed. (2d) 845, 847. In rejecting this identical untenable position of the Commissioner, the United States Circuit Court of Appeals for the Fourth Circuit in that case said:

> "It is also contended that, while dealers are allowed to deduct expenditures of this character in the year in which they are made, a different rule should apply to those who, while engaged in the business of trading in stock, are not dealers. We do not think there is any merit in this contention. Subsection (a) (1) of Section 214 of the Revenue Act of 1926 and (a) of Section 23 of the Revenue Act of 1928 make no distinction as between dealers and others who are engaged in carrying on a trade or business, nor do we see why any distinction should be made. As we said in Colony Coal & Coke Corp. v. Commissioner, 52 Fed. (2d) 923, the real test is the character of the transaction that occasions the payment."

In that case the Circuit Court allowed dividends paid on short sales to be deducted as ordinary and necessary business expenses, rather than to add such expenses to the cost of the stock. This decision was cited with approval by this Court in *Deputy* v. *DuPont*, 308 U. S. 488, 495, 60 S. Ct. 363, 367, when it clearly recognized that an active trader in securities was engaged in a "business," within the meaning of Section 23 (a). In that case this Court said:

> "Thus, it has been held that one who was an active trader in securities might take as deductions carrying charges on short sales since short selling was common in that business."

Support for the decision of the court below cannot be found in the argument that the words "amount realized" used and defined in Section 111 of the Revenue Act of 1934 furnish statutory authority for offsetting selling commissions against the actual selling price.

When Congress first defined the statutory phrase, "amount realized" in the 1924 Revenue Act, it is clear that it meant "amount received *for the property upon the sale*". Specifically, it meant the *consideration* or *selling price* for the property upon the sale, as distinguished from the selling price less the selling commission. The early construction of the original law by this court (*Walsh* v. *Brewster, etc., infra*, p. 17), in the light of the committee reports explaining these developments of the statute relating to the gain from the sale of property, makes it clear that the statutory "amount realized" was first inserted and later defined merely to give "explicit effect to the doctrine approved" by this court in those early decisions.

The provisions of law corresponding to the provisions of Section 111 (a) and (b) of Revenue Act of 1934 originated in Section 202 (a) and (c) of Revenue Act of 1924 and read as follows:

> "Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in subdivision (a) or (b) of section 204, and the loss shall be the excess of such basis over the amount realized."
>
> • • • •
>
> "The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

The report of the Ways and Means Committee (68th Cong., 1st Session, H. Rept. 179) had the following to say about this new provision of law:

> "There is no provision of the existing law which corresponds to this section of the bill. The purpose in

embodying in the law this section is to show clearly the method of determining the amount of gain or loss from the sale or other disposition of property.

(1) Subdivision (a) of this section sets forth the general rule that the amount of the gain or loss from the sale or other disposition of property is the difference between the cost or other basis of the property sold and the *amount received for the property upon the sale.* This merely embodies in the law the present construction by the department and the courts of the existing law." (Emphasis ours) (Page 12)

See also report of Senate Finance Committee, 68th Cong., 1st Session, S. Rept. 398, page 13.

It is clear, both from the report and the language of Sec. 202 (c) of the 1921 Act, that the authors of the definition were referring to the price received whether in money or property, not that price reduced by expenses incurred in making the sale or other disposition. Clearly the changes were clarifying ones. *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 468-469; *Haggar Co.* v. *Helvering*, 308 U. S. 389, 400. See also Art. 116, Regs. 33, Jan. 2, 1918.

"Profits or income derived" or "gross income" in the statutory sense, include, among other things, "profits gained through sale or conversion of capital assets," and such profits of a taxpayer include "only the difference between his investment * * * and the *amount realized.*" *Walsh* v. *Brewster*, 255 U. S. 536, 538, *Goodrich* v. *Edwards*, 255 U. S. 527, 534 and *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 519. In this latter case the "*amount realized*" was also referred to as "the *price* realized." (255 U. S. 518) In all of these cases, when this court used the expression "amount realized" it clearly meant "selling price realized." For example in *Walsh* v. *Brewster*, at page 538 of 255 U. S., it said:

"* * * the gain to the taxpayer was only the difference between his investment of $231,300 and the amount realized by the sale, $276,150."

This latter figure ($276,150) was arrived at as follows from the opinion of the District Court in *Brewster* v. *Walsh*, 268 Fed. 207, 209:

> "From the stipulation it further appears that plaintiff sold the bonds in 1916 for $276,150, part of them having been sold at 107⅜ and part at 107½."

The stipulation, page 14 of the Record before this court, No. 742, October Term 1920, shows the face value of the bonds sold at 107⅜ to have been $100,000, yielding $107,375, and the face value of those sold at 107½ to have been $157,000, yielding $168,775.

$107,375	
168,775	
$276,150	amount realized

Brokers selling commissions do not appear to have been eliminated in arriving in this computation of the "amount realized" to which this court addressed itself. Nor do they appear to have been considered in any of these cases as affecting the "amount realized." These words, therefore, were obviously employed by this court in the same sense as "selling price."

The words "amount realized" were first introduced in the Revenue Law in Section 202 (b) (1), (2) and (3) of the Revenue Act of 1921, to give "explicit effect to the doctrine approved" in *Merchants' Loan & Trust Co.* v. *Smietanka*, *Goodrich* v. *Edwards* and *Walsh* v. *Brewster* (*supra*), in computing gain or loss from the sale of capital assets. See Ways and Means Committee Report, 67th Cong. 1st Sess., H. Rept. 350, page 9 and Senate Finance Committee Report, 67th Cong. 1st Sess., Sen. Rept. 275, page 10.

Brokers commissions on the sale of "property" in its broad sense used in the statute, are not invariably withheld by the broker, from the selling price or the amount realized. When such selling commissions are so withheld, they constitute a part of the transaction between the *seller* and the

broker and *not* part of the transaction between the *seller* and the *buyer*. Until such commissions are paid, the *broker* is a *creditor* of the seller and by permitting the offsetting of this debt of the seller to the broker, against the seller's money in the hands of his *creditor* (the broker) the seller clearly "realizes" this portion of his selling price of the "property" sold, although he did not actually receive, in cash, that portion of the selling price equal to the commission so withheld. Obviously, under these circumstances, the *entire selling price* is the "amount realized." *Helvering* v. *Horst*, 311 U. S. 112, 116, 61 S. Ct. 144, 147.

In any event, "the sum of any money received" (Sec. 111 (b)) should not depend upon whether part is withheld from the purchase price, or all is paid first to the seller, who may pay his commissions or other expenses himself in cash from the gross fund. There is no more justification for offsetting *selling commissions* in arriving at the "amount realized" than there would be for offsetting *taxes* and *interest*, both of which are deductible and both of which are, in practice, withheld from the selling price by the broker.

It was necessary to use some such words as "amount realized" as defined in the statute. The words "selling price" would not suffice, because, frequently only a small portion of the selling price is received during the taxable year. Frequently, also, only a portion of the selling price is represented by cash, while the remainder is represented by property received having some fair market value.

Congress has the power to condition, limit or to deny deductions from gross income. Such deductions, thus, are allowable only as a matter of legislative grace. *Helvering* v. *Winmill*, 305 U. S. 79, 84, *New Colonial Ice Co. Inc.* v. *Helvering*, 292 U. S. 435, 440, *Helvering* v. *Independent Life Ins. Co.*, 292 U. S. 371, 381, *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 304. To say, therefore, that selling commissions are an offset against selling price, in arriving at gross income, is to say that such selling expenses are beyond the power of Congress to disallow—that their allowance,

unlike all other allowances, is *not* a matter of legislative grace.

Obviously, the word "property" is used in Section 111 and 113 in a very broad sense and includes real estate, securities, stocks, bonds and commodities. There is no statutory warrant for not computing the gain or loss from the sale or disposition of all "property" consistently, whether it be real estate, securities or commodities.

The "construction by the department and the courts of the existing law" as at the time of the passage of the 1924 Act, insofar as it applies to the treatment of *selling commissions* on "property" sold in the course of one's trade or business, is indicated by the commissioner's ruling of September 1926, namely, I. T. 2305 published on page 108 of Cumulative Bulletin V-2. This ruling reads as follows:

> "In the case of sales of real estate by persons not regularly engaged in that business, commissions paid, while they *do not reduce or otherwise affect the amount of the selling price*, may be offset against the selling price in determining the amount of gain or loss realized from such sales, and in cases of installment sales in determining the percentage of profit in each installment payment which is to be included in gross income.
>
> "Dealers in real estate should deduct commissions paid for the sale of real estate as a business expense for the year in which paid or accrued, in accordance with the basis on which their books are kept." (Emphasis ours)

The words "dealers in real estate" have no significance either under the Statute or the Regulations. The allowance of commissions on real estate sales as a business expense was approved by the Board of Tax Appeals in *The Highlands Trust*, No. 1546, 32 B. T. A. 760, (June 12, 1935) expressly on the authority of I. T. 2305 quoted above. In that case the taxpayer was seeking to add commissions to the cost of real estate sold during the year. This the Board refused to do, saying at page 766:

"We gather from statements in the deficiency notice and the briefs of the parties that the respondent treated the commission retained by the Paramount Realty Corporation as a deductible business expense rather than as a reduction of either the selling price of the lots or the initial payment thereon. *This is in accordance with the long established practice of the Bureau.* See I. T. 2305, C. B. V-2, P. 108; art. 352, Regulations 74 and 77; art. 44-2, Regulations 86. Petitioners' claim, as we understand it, is that the net amount received after deducting the part retained by the Paramount Realty Corporation should be treated as the selling price. This would have the effect of throwing back into the earlier years some of the profit ultimately realized on the deferred payment sales. We know of no authority for this method of computing income. The gross amount which purchasers contracted to pay was the selling price and must be accounted for as such, regardless of bookkeeping or accounting methods. *Commissions on sales are business expenses to be deducted in the years of accrual or payment, according to whether the taxpayer is on the accrual or cash basis, and are to be deducted in arriving at net income.* This is the normal method of determining income and petitioners have not shown any reason for a departure therefrom. Some argument is made as to the lack of value of the sales contracts. We do not see what this has to do with the question presented; moreover, there is no evidence at all as to the value of the contracts." (Emphasis ours)

See also *Clarence Whitman* v. *Commissioner*, 16 B. T. A. 197, 199, affirmed (C. C. A. 2) 49 Fed. (2d) 1087, *Alexander Sprunt & Son Inc.* v. *Comm.*, 64 Fed. (2d) 424, 428 and *Kornhauser* v. *U. S.*, 276 U. S. 145.

The principle is equally applicable under the Statute (Sec. 111 and 113) to one whose trade or business involves the purchase and sale of securities, commodities or real estate for a profit. The selling commissions constitute "compensation for personal services actually rendered," "in carrying on any trade or business," and are clearly deductible.

It is obvious, therefore, that insofar as selling commissions on "property" sold in the course of ones trade or business is concerned, there is nothing either in the law or the regulations which evinces an intent, clear or otherwise, "to withdraw that special type of commissions from the general classification of Article 121" as this court found to exist with respect to "security purchase commissions" in the *Winmill* case. (305 U. S. 83, 84).

It was principally on the narrow ground that *purchase* commissions were by the law (Section 113(b)(1)) and by the Regulations (Art. 282) made a part of the cost of securities, that this court differentiated "security *purchase* commissions" from "commissions" in general in the *Winmill* case.

In the *Winmill* case, this difference between buying and selling commissions was undoubtedly the circumstance which led the Government to petition for certiorari only as to the *buying* commissions and not as to the *selling* commissions, although both were equally available for certiorari *if there is no difference between the two.* As a matter of fact the purchase commission's issue involved a claimed deduction in the amount of only $7,493.51 in the *Winmill* case, whereas the selling commissions issue involved $9,574.00. Both buying and selling commissions had been allowed specifically by the United States Circuit Court of Appeals for the Second Circuit, in that case, therefore, if there was no difference between them, both were available for review on certiorari. (See Transcript of Record, pages 9, 10, *Helvering* v. *Winmill,* No. 860, October Term, 1937, U. S. Supreme Court.)

The petition for certiorari in the *Winmill* case raised only the issue with respect to "brokerage purchase commissions in the purchase of securities, the sum of $7,493.00." The briefs of both parties and the decision of the Court only dealt with purchase commissions. The Circuit Court of Appeals in its decision (93 Fed. (2d) 494) allowed both buying and selling commissions. "The Government by failing to seek review of the ruling (on selling commissions)

has acquiesced in it." *Helvering* v. *Union Pacific Railroad Co.*, 293 U. S. 282, 285. This acquiescence is all the more significant because of the fact that the Government was deliberately distinguishing between buying and selling commissions by carefully selecting the purchase commissions issue for review and refraining from seeking review of the selling commissions issue, although both were involved in that single case and although both were available, if there was no difference between them. See page 7 of Brief of petitioner, no. 11, October Term 1938, wherein it is carefully stated:

> "The petition for certiorari sought a review of the decision only so far as it related to the commissions paid on the purchase of shares of stock, in the amount of $7,896.50 ($7,493.59 plus $403)."

The final mandate of the Circuit Court of Appeals in the *Winmill* case, after the partial reversal by this court, required the Board to deduct the selling commissions. The case was closed before the Board on this basis.

In *Commissioner* v. *Covington*, 120 Fed. (2d) 768, 771, the United States Circuit Court of Appeals for the Fifth Circuit recognized the modified language employed in Article 282 of Regulations 77 regarding selling commissions as deductible expenses where they are ordinary and necessary business expenses stating: "But it is also true that it has been uniformly held that this exception applies only to dealers in securities and that this provision was made and applied where the details of accounting in the dealers' business made it impractical for him to match his selling commissions against each individual sale," citing G. C. M. 15430, Cum. Bull. xiv-2, page 59.

G. C. M. 15430 is merely an opinion of the lawyer for the Commissioner of Internal Revenue. It does not have the force and effect that a Treasury Decision promulgated by the Commissioner with the approval of the Secretary of Treasury would have, and it cannot have the effect of modifying the meaning of Article 282 of Regulations 77.

The Commissioner of Internal Revenue was in September 1935 (when G. C. M. 15430 was published) actively engaged in the litigation affecting the construction of the law and regulations with respect to purchase and selling commissions: The *Winmill* case, in which these questions were actively being raised, was then set for hearing before the Board of Tax Appeals. It hardly seems appropriate, therefore, to give this opinion any greater weight than the brief of any other party to litigation of this sort.

Relative administrative expediency in the computation of business expenses does not warrant the discriminatory disallowance to one and the allowance to another of what in substance is the same thing, yet this is exactly what the Commissioner's lawyer in G. C. M. 15430 says has been the practice, and he does not even say that there is the slightest difficulty in determining the amount of the selling commissions of the "traders". The pretended difficulty lies only in the wholly unnecessary matching of selling commissions against individual sales in the case of the "dealer". Inferentially he argues, therefore, even though they may represent "compensation for personal services actually rendered" in the course of "carrying on any trade or business," and even though the statute mandatorily provides that such expenses shall be allowed as deductions, the Commissioner's basis of disallowance of such ordinary and necessary expenses to the *trader* is the alleged difficulty experienced in matching such commissions with each individual sale in the case of a so-called *"dealer."*

The only possible excuse for not allowing the deduction of brokers' commissions in connection with buying and selling securities or commodities, would be first that certain commissions might be "properly chargeable to capital account" under the terms of the statute.

The opinion of the Court in *Commissioner* v. *Covington* (*supra*), contains an unfortunate material misstatement of fact in this regard. For example the following statement appears in that opinion.

"The regulations of the Treasury Department have consistently provided, that deductions for commissions paid in the purchase and sale of securities by one who is not a dealer, are not deductible as business expenses, that commissions paid on purchases shall constitute a part of the cost of the securities, and commissions paid on sales shall be deducted from the selling price." 120 Fed. (2d) 768, 770.

As a matter of actual fact the *regulations* of the Treasury Department never in any case have provided that deductions for commissions paid in the sale of securities by *one who is not a dealer, are not deductible as business expenses.* This holding, however, appeared only in G. C. M. 15430 (*supra*), not in the regulations. This ruling is neither a Treasury Decision, nor a Regulation of the Treasury Department. It does not have the approval of the Secretary of the Treasury and when published by the Commissioner carried with it the warning that such informal rulings so published "have none of the force and effect of Treasury Decisions and do not commit the Department to any interpretation of law."

This court has consistently held that such "departmental rulings not promulgated by the Secretary" (of the Treasury) "are of little aid in interpreting a tax statute." *Biddle* v. *Commissioner*, 302 U. S. 574, 582, *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 467, 468, where the Court called attention to the above quoted cautionary notice invariably published on the covers of the bulletins containing administrative rulings of the Bureau. See also *Higgins* v. *Commissioner, supra,* in which such rulings were referred to as "rulings of less dignity" than those approved by the Secretary of the Treasury. (312 U. S. 212, 215)

It matters not how much the discriminatory administrative practice may have been followed, such practice cannot have the effect rarely even accorded Treasury decisions of *changing the law* through the process of the tacit approval by Congress following subsequent reenactments of the law

without substantial change. *Biddle* v. *Commissioner, supra, Helvering* v. *New York Trust Co.* (*supra*).

The language of the statute permitting the deductibility of "compensation for personal services actually rendered," when such compensation is not properly chargeable to capital account, is entirely free from ambiguity. In the face of this clear language there is no excuse whatsoever for indulging in a construction of that language that will result in allowing "dealers" to deduct selling commissions on the sale of securities and to prohibit a similar benefit to persons who are merely known as "traders."

What is the ambiguity in this language which warrants the resort to the principles of constructions? And by what specious reasoning can such a discriminatory construction result from the reading of the plain terms of the act?

> "It is elementary that, where no ambiguity exists, there is no room for construction. Inconvenience or hardships, if any, that, result from following the statute as written, must be relieved by legislation. * * * Construction may not be substituted for legislation. *United States* v. *Wiltberger*, 5 Wheat. 76, 95-96, 5 L. Ed. 37; *United States* v. *Fisher*, 2 Cranch, 358, 386, 2 L. Ed. 304; *Lake County* v. *Rollins*, 130 U. S. 662, 670, 9 S. Ct. 651, 32 L. Ed. 1060; *Caminetti* v. *United States*, 242 U. S. 470, 37 S. Ct. 192, 61 L. Ed. 442, L. R. A. 1917F, 502 Ann. Cas. 1917B, 1168; *Ex Parte Public National Bank*, 278 U. S. 101, 49 S. Ct. 43, 73 L. Ed. 202; *United States* v. *Colorado & N. W. R. Co.* (C. C. A.), 157 F. 321, 327, 15 L. R. A. (N. S.) 167, 13 Ann. Cas. 893."
>
> *United States* v. *Missouri Pacific Railroad Co.*, 278 U. S. 269, 277.

As stated by the Supreme Court in the case of *DeGaney* v. *Lederer*, 250 U. S. 376, 381:

> "Unless the contrary appears, statutory words are presumed to be used in their ordinary and usual sense and with the meaning commonly attributable to them."

The words "compensation for personal services" as used in Section 23 (a) of the Revenue Act of 1934 are presumed

to be used in their ordinary and usual sense and with the meaning commonly attributable to them. In that sense and with that commonly attributable meaning, these words include compensation in the form of broker's selling commissions and when such compensation is paid in connection with the sale of stocks in the course of the ordinary and necessary operations of a taxpayer's trade or business, the statute mandatorily requires that said compensation for services actually rendered "shall" be allowed as a deduction in computing income.

Therefore the above language of the statute must be given effect according to its plain and unambiguous language. There is no occasion for construction of the phrase "compensation for personal services actually rendered." Such compensation is deductible unless it is "properly chargeable to capital account," within the clear meaning of that phrase as explained in the report of the Committee on Ways and Means, first introducing that language into the law.

In view of the foregoing it is clear that the selling commissions in the instant case are ordinary and necessary expenses of carrying on "any trade or business" because they constitute "compensation for personal services actually rendered" in connection therewith. The selling commissions are therefore deductible from this taxpayer's gross income for the taxable years 1934 and 1935.

CONCLUSION.

The judgment of the Circuit Court of Appeals should be reversed. Respectfully submitted.

WALTER SLACK,
433 California St.,
San Francisco, Calif.

THOMAS M. WILKINS,
Union Trust Bldg.,
Washington, D. C.,
Attorneys for Petitioner.

January 27, 1942.